

CALIFORNIA

• BUDGET PROJECT •

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How Should Tax Expenditures Be Evaluated?

In order to provide oversight and ensure accountability, tax expenditure review should include:

1. **Sunset.** Because of the differential vote requirement for creating and eliminating tax expenditures – they can be created by majority vote, but require a two-thirds vote to repeal – sunset dates are essential for providing the Legislature the opportunity to eliminate tax expenditures that are inefficient, ineffective, or of lower priority than alternative uses for state resources.
2. **A statement of goals and objectives.** Tax expenditures should include intent language that clearly lays out the problem and how the tax incentive will address the problem. This language can outline the goals by which a tax expenditure should be evaluated.
3. **Reporting requirements.** All measures that create, modify, or extend a tax expenditure should include meaningful reporting and evaluation requirements. Components of such a report should include:
 - a. The social and policy objective for each tax expenditure;
 - b. The revenue loss attributable to the tax expenditure (state and any applicable local government loss);
 - c. The social or economic outcome or behavior affected by each tax expenditure;
 - d. The change in taxpayer behavior or outcome associated with each tax expenditure;
 - e. Any similar or identical federal tax expenditures;
 - f. Any similar or identical “on-budget” stage programs;
 - g. An assessment of the cost effectiveness of each tax expenditure at meeting its identified policy objective;
 - h. An examination of which income groups or taxpayers (i.e., industries) receive benefits from each tax expenditure, the distribution of benefits among different income groups, and the effect of the tax expenditure on the overall distribution of the tax burden;
 - i. An assessment of whether adequate data is available to conduct the required evaluation;
 - j. Recommendations to insure that adequate data is made available to enable further analyses; and
 - k. An assessment of the extent to which the tax expenditure:
 - i. Provides windfall benefits to individuals or groups whose behavior is unaffected by the tax expenditure;
 - ii. Works contrary to the objectives of other state programs or policies;
 - iii. Has outcomes that are inconsistent with the original goals and objectives for which they were intended;

- iv. Fails to provide social or economic benefits to the state on a cost effective basis; or
 - v. Provides benefits to a single or limited number or segment of taxpayers.
- 4. **Performance standards.** Tax expenditures that are aimed at encouraging certain behaviors should have performance standards. Measures that are aimed at job creation, for example, could include a minimum threshold for the number of jobs and/or wage level of jobs created to limit availability of a tax expenditure to firms that actually deliver promised benefits.